UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF ALABAMA

In re:

THE COLONIAL BANCGROUP, INC.,

Debtor.

Case No. 09-32303-DHW
Chapter 11

MEMORANDUM OPINION

The Colonial BancGroup, Inc. ("debtor") filed an objection to the claim of Texas Comptroller of Public Accounts ("TCPA"). The debtor denies that any amount is owed. In the alternative, the debtor contends that any amount owed is not entitled to priority status under 11 U.S.C. § 507(a)(8). Upon consideration of the undisputed facts, the controlling law, and the respective briefs of the parties, the court concludes that the debtor's objection to the claim must be overruled.

Jurisdiction

The court's jurisdiction in this dispute derives from 28 U.S.C. § 1334 and from an order of the United States District Court for this district wherein that court's jurisdiction in title 11 matters was referred to the Bankruptcy Court. *See* General Order of Reference of Bankruptcy Matters (M.D. Ala. Apr. 25, 1985). Further, because the dispute concerns the allowance or disallowance of a claim against the debtor's estate, this is a core proceeding, pursuant to 28 U.S.C. § 157(b)(2)(B), thereby extending this court's jurisdiction to the entry of a final order or judgment.

Undisputed Facts

The debtor is a corporation formed under the laws of the State of Delaware, and its headquarters and principal place of business was located in Montgomery, Alabama. Two of the debtor's subsidiaries, Colonial Bank and Colonial Brokerage, conducted business in Texas through August 2009.[1] Other

[1] The parties do not dispute that the Bank ceased doing business in Texas in August 2009. Because of the decision in this case, it is not material whether Colonial

than through its subsidiaries, the debtor did no business in Texas in that year.

The debtor's 2009 Texas Franchise Tax Report was due initially on May 15, 2009. The debtor, on behalf of the combined group, sought an extension for filing the report. Along with the extension request, the debtor paid $575,000 based on its estimate of the tax owed.

On August 14, 2009, Colonial Bank was taken over by bank regulators and closed. On August 25, 2009, the debtor filed a chapter 11 petition for relief in this court. Colonial Brokerage filed a chapter 7 petition for relief in this court on June 7, 2010.

In September 2009, the debtor filed the 2009 Texas Franchise Tax Report. That report reflected a liability of $695,849.54. The debtor had already paid $575,000.00 with the extension request, leaving an unpaid tax, per the report, of $120,849.54.

On February 16, 2010, TCPA filed a claim for taxes, penalties, and interest in the aggregate amount of $133,511.43 for the reporting period of January 1, 2009 through December 31, 2009.[2] TCPA designated the claim as a priority unsecured claim under 11 U.S.C. § 507(a)(8).

Contentions of the Parties

First, the debtor contends that it does not owe the claim. The debtor argues that because the debtor's affiliates conducted business in Texas for only eight months in 2009, its franchise tax liability should be apportioned accordingly. The debtor contends that its estimated payment of $575,000.00 exceeds the prorated amount due.

Next, the debtor maintains that even if an amount is still owing, it is not entitled to priority under § 507(a)(8). In attacking the priority status of the claim, the debtor asserts that: 1) the claim is not an excise tax "on a transaction"

Brokerage conducted business in Texas after August 2009.

[2] TCPA added pre-petition interest of $576.93 and pre-petition penalties of $12,084.96 to the $120,849.54 due under the debtor's report to arrive at $133,511.43.

within the meaning of § 507(a)(8); 2) the return was due outside the time parameters of § 507(a)(8); 3) the interest and penalty components of the claim are not entitled to priority.

TCPA takes issue with all of the debtor's contentions.

Conclusions of Law

The State of Texas imposes a franchise tax "on each taxable entity that does business in this state or that is chartered or organized in this state." Tex. Tax Code Ann. § 171.001(a). The tax is "imposed on all domestic and foreign corporations for the privilege of doing business in the state. The grant of this privilege confers upon corporations various economic benefits, including the opportunity to realize income and the right to invoke the protection of Texas law." *In re National Steel Corp.*, 321 B.R. 901, 906 (Bankr. N.D. Ill. 2005).

Taxable entities that are part of an affiliated group engaged in a "unitary business" are required to file a combined group report on the combined group's business in lieu of individual reports. Tex. Tax Code Ann. § 171.1014(a). The combined group is a single taxable entity for franchise tax purposes. *Id.* at (b). The debtor and its affiliates, Colonial Bank and Colonial Brokerage, were engaged in the same general line of business, namely financial services. Hence, they were a "unitary business" for franchise tax purposes.[3]

The debtor does not dispute that it is liable for franchise taxes as part of the combined group.[4] However, the debtor contends that its liability should be

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[3] *See* Comptroller Rule 3.590(b)(6) (providing that a factor in determining whether affiliates are a unified business is whether they are engaged in the same general line of business such as finance).

[4] The court notes that bank holding companies have repeatedly been treated as unitary businesses for franchise tax purposes. *See Wachovia Bank of North Carolina, N.A. v. Johnson*, 26 S.W.3d 621, 624-25 (Tenn. Ct. App. 2000); *Firstar Corp. v. Commissioner of Revenue*, 575 N.W.2d 835, 837 (Minn. 1998); *Calhoun County Board of Supervisors v. Grenada Bank*, 543 So. 2d 138, 141 (Miss. 1988); *Independent Southern Bancshares v. Huddleston*, 912 S.W.2d. 705, 706 (Tenn. Ct. App. 1995); *U.S. Bancorp v. Oregon Dep't of Revenue*, 1994 WL 235462, *2 (Or. Tax 1994).

prorated based on the months its subsidiaries operated in Texas. If the tax is prorated, no further amount is due. The debtor calculate this as follows. The total liability for 2009 of $695,849.54 represents a tax of $57,987.46 per month. The debtor's subsidiaries did business in Texas for only 8 months in 2009. $57,987.46 multiplied by 8 months equals only $463,899.69. The debtor paid $575,000 with its request for an extension, essentially overpaying the tax by $111,100.31.

The issue is whether a corporation may prorate its franchise tax liability if it ceases to do business in the state within the reporting period. TCPA correctly relies upon the holding of the Supreme Court in *New York v. Jersawit*, 263 U.S. 493, 44 S. Ct. 167 (1924). In that case, the debtor filed a bankruptcy petition in December and ceased business operations in New York the same day. The debtor's franchise tax period ran from November through October. Therefore, the bankruptcy occurred about two months into the franchise tax year. In reversing the bankruptcy and district courts, the Court held that "[t]he amount to be paid is not determined by the business done during the period taxed but by the net income of the year before." 44 S. Ct. at 168. Therefore, the court held that the state's claim for the entire unapportioned sum should have been allowed.

The franchise tax in Texas is similar to the New York tax in *Jersawit*. The amount of the tax for the reporting period is measured by the business done by the corporation in the prior period. The amount of the tax due became fixed and noncontingent at the beginning of the reporting period. Therefore, the cessation of business in 2009 by the debtor's subsidiaries had no effect upon the amount of the tax owed, and the amount owed may not be prorated.

Having found that the TCPA claim is not due to be prorated, the court turns to the issue of whether the claim is entitled to priority under § 507(a)(8). First, the debtor maintains that the Texas franchise tax is not an excise tax "on a transaction" entitled to priority under § 507(a)(8)(E). The Code provides in pertinent part:

> (8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for — . . .
>
> (E) an excise tax on —
>
> (i) a transaction occurring before the date of the

> filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition;

11 U.S.C. § 507(a)(8)(E)(i).

The Texas franchise tax is a tax on the privilege of transacting business in the state. *Bullock v. National Bancshares Corp.*, 584 S.W.2d 268, 270 (Tex. 1979); *Rylander v. Fisher Controls Int'l, Inc.*, 45 S.W.3d 291, 293 (Tex. App 2001). While the bankruptcy statute (§ 507(a)(8)(E)) does not provide a definition of the term "excise tax," numerous courts have adopted the definition of the term used in *Black's Law Dictionary*:

> "A tax imposed on the performance of an act, the engaging in an occupation, or the enjoyment of a privilege. A tax on the manufacture, sale, or use of goods or on the carrying on of an occupation or activity, or a tax on the transfer of property. In current usage the term has been extended to include various license fees and practically every internal revenue tax except the income tax. . . ."

In re National Steel Corp., 321 B.R. 901, 908 (Bankr. N.D. Ill. 2005) (quoting *Black's Law Dictionary* 563 (6th ed. 1990)). *National Steel* collects numerous cases broadly construing excise taxes to include almost any indirect tax. *See National Steel*, 321 B.R. at 908.

The court concludes that a franchise tax like the one in Texas is an excise tax levied for the privilege of doing business in the state.[5]

However, the debtor notes that in order for an excise tax to receive priority status under § 507(a)(8)(E), the excise tax must be on a "transaction." The debtor contends that the Texas franchise tax is imposed on the general privilege

[5] *See also Universal Frozen Foods Co. v. Rylander*, 78 S.W.3d 588, 590 (Tex. App. 2002); *Educational Films Corp. v. Ward*, 41 F.2d 395, 397 (S.D.N.Y. 1930); *Hollingsworth & Whitney Co. v. State*, 1 So.2d 387, 388 (Ala. 1941).

of conducting business in Texas and not on any particular transaction. This argument was addressed in *In re National Steel Corp.*, 321 B.R. 901 (Bankr. N.D. Ill. 2005). In examining the Texas franchise tax, the court stated:

> In the matter at bar, the state franchise tax is imposed upon corporations transacting business in Texas. That business necessarily encompasses and requires a variety of transactions. Whether a transaction consists of hiring a worker, executing a contract, operating a vehicle on Texas roadways, renting office space, or selling goods, any single transaction requires the corporation to pay state franchise tax for that calendar year. The Trust does not dispute that [the debtor] conducted business in Texas during calendar year 2002, thereby exercising a privilege that confers upon corporations various economic benefits, as well as the opportunity to invoke the protection of Texas law. Therefore, [the debtor] incurred liability for corporate franchise tax under the Texas Tax Code. That the tax is not imposed on a discrete, readily identifiable transaction is of no consequence.

National Steel Corp., 321 B.R. at 912. The court finds this language persuasive and holds that the Texas franchise tax qualifies as a tax on a transaction for purposes of § 507(a)(8)(E).

The debtor further contends that the rationale of *National Steel* should not be extended to the instant case because the debtor in *National Steel* actually conducted business in the state of Texas while the debtor in the instant case did not. The debtor states: "the TCPA seeks recovery from the Debtor not because it conducted actual business operations in Texas at any time during 2009 but rather because it is the parent corporation of the consolidated group." Debtor's objection to Claim, Doc. #1396, p. 9. Debtor's Brief, Doc. #1543, p. 10. And again, "[t]he TCPA Claim is for a tax imposed entirely upon the business activity of Colonial Bank and Colonial Brokerage, Inc." Debtor's Brief, Doc. 1543, p. 2. And again, the debtor states that the TCPA is not asserting the priority claim "on the basis of any transaction by the Debtor." Debtor's Brief, Doc. 1543, p. 10.

However, the Bankruptcy Code does not make such a distinction. Section 507(a)(8)(E) does not require that the transaction on which the tax is imposed be made by the debtor. The section merely requires that the excise tax for which the

debtor is liable be "on . . . a transaction." This court concluded above that the franchise tax meets the "transaction" test, and it is undisputed that the debtor is liable for the tax as a member of the consolidated group. Therefore, the tax is not disqualified from priority status on that ground.

Next, the debtor contends that the Texas franchise tax does not enjoy priority status in this case because it falls outside the time parameters established in 11 U.S.C. § 507(a)(8)(E)(i). The debtor contends that, because of the extension received, the franchise tax return was not "last due, under applicable law or under any extension," until after the date of the filing of the petition. Section 507(a)(8)(E)(i).

The debtor construes the statute to mean that excise taxes predicated on a return that is last due post-petition are not entitled to priority status. The court disagrees. The statute provides that for a claim to enjoy priority status, the return must be last due after three years before the petition date. The fact that, in this case, the extension was for a period beyond the petition date has no effect upon the priority status of the claim. *See In re New England Carpet Co.*, 26 B.R. 934, 940-41 (Bankr. D. Vt. 1983) (personal property taxes); *In re Wang Zi Cashmere Products, Inc.*, 202 B.R. 228, 231 (Bankr. D. Md. 1996) (personal property taxes).

Finally, the debtor objects to the priority status of the pre-petition interest and penalty components of TCPA's claim. TCPA claims penalties of $12,084.96 and interest in the amount of $576.93. It is well established that interest has the same priority as the underlying tax provided that the interest accrued pre-petition. *Bates v. United States (In re Bates)*, 974 F.2d 1234, 1237 (10th Cir. 1992); *Jones v. United States (In re Garcia)* (equating interest to a pecuniary loss penalty), 955 F.2d 16, 19 (5th Cir. 1992); *In re Larson*, 862 F.2d 112, 119 (7th Cir. 1988); *Hamrick v. United States (In re Hamrick)*, 259 B.R. 224, 229 (Bankr. M.D. Ga. 2000); *Simmons v. United States (In re Simmons)*, 227 B.R. 338, 341 (Bankr. N.D. Ga. 1998); *In re Teeslink*, 165 B.R. 708, 717 (Bankr. S.D. Ga. 1994). The court agrees with the preceding authority that pre-petition interest accrual enjoys the same priority as the underlying claim.

Concerning the priority status of the penalty portion of its claim, TCPA, in brief, acknowledges that $11,240.77 of the claimed penalty is not entitled to priority status. Nevertheless, TCPA maintains that $844.29 of the penalty

component is due priority status.

Tax penalties enjoy priority status under only if they are in compensation for actual pecuniary loss. The statute provides:

> (8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for—
>
> > (G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.

11 U.S.C. § 507(a)(8)(G). When a taxing authority assesses both penalties and interest, "it is questionable that a compensatory role should be assigned to these penalties in light of the fact that interest is additionally charged. The pecuniary loss . . . is the loss of the use of the tax money." *In re New England Carpet Co.*, 26 B.R. 934, 936 (Bankr. D. Vt. 1983); *In re Healis*, 49 B.R. 939, 942 (Bankr. M.D. Pa. 1985). *In re Hirsch-Franklin Enterprises, Inc.*, 63 B.R. 864, 873-74 (Bankr. M.D. Ga. 1986), *rev'd on other grounds*, *Varsity Carpet Services, Inc. v. Richardson (In re Colortex Industries)*, 19 F.3d 1371 (11th Cir. 1994).

However, under Texas law, interest does not accrue on delinquent taxes for the first 60 days following the due date. Tex. Tax Code Ann. § 111.060(c). Therefore, the penalty may be considered compensation for pecuniary loss during that 60-day period in which interest did not accrue. TCPA pegs that figure at $844.29, and the court concurs.[6] Hence, only $844.29 of the penalty component of TCPA's claim enjoys priority.

Conclusion

For these reasons the debtor's objection to the allowance and priority status of the TCPA's franchise tax claim will overruled. The claim is allowed and enjoys priority status in the amount of $122,270.66. The balance,

[6] If the Texas statute did not preclude interest during the 60-day period, interest accrual on $120,849.54 at 4.25% would have totaled $844.29: $120,849.54 principal amount times 4.25%, divided by 365 days in a year, times 60 days = $844.29. The court notes that the 4.25 % interest rate is authorized pursuant to Texas Tax Code which prescribes prime rate plus one percent. Tex. Tax Code Ann. § 111.060.

$11,240.77, is allowed as a general, unsecured claim. Pursuant to Fed. R. Bankr. P. 9021, an order in accord with this memorandum opinion will enter separately.

Done this the 3rd day of February, 2012.

/s/ Dwight H. Williams Jr.
United States Bankruptcy Judge

c: C. Edward Dobbs, Debtor's Attorney
Mark Browning, TCPA's Attorney

3 2/6/12TATES BANKRUPTCY COURT
MIDDLE DISTRICT OF ALABAMA

In re: Case No. 09-32303-DHW
Chapter 11

THE COLONIAL BANCGROUP, INC.,

Debtor.

ORDER OVERRULING OBJECTION TO CLAIM

In accordance with the Memorandum Opinion entered this day, it is hereby

ORDERED that the debtor's objection to Claim #174 filed by the Texas Comptroller of Public Accounts is OVERRULED, and the claim is ALLOWED as a priority claim in the amount of $122,270.66 and as a general unsecured claim in the amount of $11,240.77.

Done this 6th day of February, 2012.

/s/ Dwight H. Williams, Jr.
United States Bankruptcy Judge

c: C. Edward Dobbs, Debtor's Attorney
Mark Browning, TCPA's Attorney